IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 102 of 1986

For Approval and Signature:

Hon'ble MR.JUSTICE M.S.SHAH Sd/-
and
Hon'ble MR.JUSTICE D.A.MEHTA Sd/-

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

M/S. SADHURAM GORDHANDAS

Versus

COMMISSIONER OF INCOME-TAX

Appearance:

MR BD KARIA for Applicant.

MR BB NAYAK FOR MR MANISH R BHATT for Respondent.

CORAM : MR.JUSTICE M.S.SHAH
and
MR.JUSTICE D.A.MEHTA

Date of decision: 14/09/2001

ORAL JUDGEMENT

(Per : MR.JUSTICE D.A.MEHTA)

The Income-tax Appellate Tribunal, Ahmedabad

Bench "B" has referred the following six questions for the opinion of this Court in compliance with the directions issued by this Hon'ble Court under section 256(2) of the Income Tax Act,1961 (hereinafter referred to as 'the Act').

"1. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law upholding that the Income-tax Officer had lawfully reopened assessment proceeding under Sec.147(a) of the Income-tax Act,1961 ?

2 Whether, the Tribunal was justified in taking into account irrelevant aspect such as Voluntary Disclosure Scheme and the disclosure made thereunder etc. as against the question of mere difference of opinion on the valuation of the closing stock for the purpose of legality of reopening of the proceedings?

3 Whether, the Tribunal was correct in holding that the finding of the Commissioner (Appeals) on the point was totally untenable having no factual basis and whether the said finding is not contrary to the consistent stand adopted by the Income-tax Officer in form of mere under valuation of closing stock ?

4 Whether, the Tribunal had jurisdiction to put a new case altogether against the assessee of 'Non-disclosure' rather than 'under disclosure' changing the entire complexion of the case ?

5 Assuming that the reopening proceedings were validly initiated, whether the Tribunal was further justified in valuing the closing stock of Rs.92,000/- resulting in addition of Rs.32,000/- on merits especially when the closing stock was properly valued by the assessee at market price or cost whichever is lower at the initial stage ?

6 Whether, the Tribunal was correct in justifying the rough and ready cost of construction leading to the addition of

Rs.32,000/- to the taxable income of the assessee ?"

2 The assessee is a registered firm. The business of the assessee is that of a building contractor and in the course of its business it purchases a plot of land and after constructing flats, shops etc., sells the completed premises.

3 The assessment year is 1971-72 and the relevant accounting period is "Ramnavmi" i.e year ended on 5/4/1971. During the accounting period the work of constructing flats in "Apollopark" flats and "Saraswati Chambers" was completed. The cost of construction of the said premises, as per the accounts filed with the Income Tax Officer was Rs.4,94,826/- being the brought forward balance plus Rs.1,66,009/- being the cost of construction incurred during the previous year i.e. totalling to Rs.6,60,835/-. As against this, on total sales of Rs.8,37,000/- a gross profit of Rs.1,76,175/was shown and the same came to be accepted in the original assessment.

4 The assessment framed originally under Section 143(3) of the Act was reopened under section 147(a) of the Act; for the purpose of reopening the Income Tax Officer observed as follows :

"Subsequent to the completion of the said assessment year and during the course of the assessment proceedings for the A.Y. 1973-74, it came to light that the assessee had concealed income by understating the value of the closing stock of flats in Saraswati Chambers, constructed by the assessee firm during the accounting year relevant to the A.Y. 1971-72"

In pursuance of notice under section 148 of the Act, the assessee filed its return of income on 10/3/1980.

5 On 11/3/1980, a notice under section 143(2) of the Act was issued seeking compliance on 18/3/1980. The relevant portion of the said show cause notice reads as under:

"Sub : Suppression of sales in the case of flats, shops and basement in Saraswati Chambers - Assessment Year 1971-72 and

1972-73 Show cause.

While looking into your accounts, relevant to the asstt.year 1973-74, the I.T.O. made a detailed enquiry/investigation in respect of the construction and sale of flats, shops etc. in Saraswati Chambers, at Gandhinagar, Ahmedabad. From the said inquiry/investigation, it came to the light that you have suppressed the closing stock of the aforesaid building in your accounts maintained for the asstt.year 1971-72 and further you have suppressed the sales of flats, shops etc. in the said Saraswati Chamber in your books of account maintained for the asst.year 1972-73 xxx xxx ".

"3. Reg.Asstt.Year 1971-72.

After considering the facts and circumstances of the case I estimate the suppression of your closing stock of the Saraswati Chambers at Rs.1,00,000/-. This is proposed for addition for the asst.year 1971-72 xxx xxx xxx"

It is pertinent to note that the assessments for assessment years 1971-72 and 1972-73 were reopened simultaneously and the reassessment proceedings were also conducted simultaneously and that is how the aforesaid common show cause notice for two assessment years was issued by the Income Tax Officer.

6 Thereafter, the Income Tax Officer analysed the combined trading account pertaining to construction of the "Appollopark" flats and "Saraswati Chambers" and came to the conclusion that the sale of eight flats of Saraswati Chambers declared by the assessee at Rs.60,000/- was in reality not effected before the close of the accounting period. According to the Income Tax Officer the said eight flats in Saraswati Chambers had actually been sold by executing hire purchase agreement on 21/5/1971 which date fell beyond the accounting period relevant for the assessment year under consideration and hence according to the Income Tax Officer the sale had taken place in assessment year 1972-73. The Income Tax Officer was thus of the opinion that it was necessary for the assessee to show the value of the said eight flats in the closing stock and accordingly he called upon the assessee to furnish the details of cost of construction. The assessee accordingly furnished the cost of

construction of the entire building of "Saraswati Chambers" and therefrom the cost of eight flats was worked out to a round figure of Rs.92,000/-. The Income Tax Officer adopted this cost of construction as closing stock in hands of assessee firm for the assessment year under consideration. However, as the assessee had already declared receipt of Rs.60,000/- as being income in relation to sale of eight flats of "Saraswati Chambers" by including the said amount as sales in the trading account the Income Tax Officer made an addition of Rs.32,000/- (Rs.92,000/- minus Rs.60,000/-). Accordingly, the assessment was completed on 25/3/1980.

7. The assessee went in appeal and the C.I.T.(Appeals) for the reasons stated in his order dated 21/4/1981 held that in fact there was no suppression of closing stock but there was a difference of opinion as regards valuation of closing stock and that the choice as regards method of valuation of closing stock rested with the assessee and as the assessee had valued the closing stock at market price it was not necessary to revalue the same as was undertaken by the Income Tax Officer.

8. The revenue preferred an appeal before the Tribunal. The Tribunal after upholding the reassessment proceedings held that the sale of eight flats had not taken place during the year under consideration and the assessee was obliged to show the value of the same as forming part of its stock in trade. The Tribunal further held that the value of Rs.60,000/- placed on the eight flats as on 5/4/1971 i.e. on the last day of the accounting period could not be the market price of the said flats because if the flats had been sold on ownership basis the sale price would have been Rs.1,12,300/-. This figure was adopted by the Tribunal from the working given by the assessee which is available at page 40 of Paper Book. Accordingly, the Tribunal allowed the revenue's appeal by its order dated 12/10/1983.

9. Mr.B.D.Karia, learned Counsel appearing on behalf of the applicant assessee pointed out that the working on which the reliance was placed by the Tribunal had been submitted by the assessee alongwith its reply dated 13/12/1975 addressed to the Income Tax Officer. It was submitted that it was at the behest of the Income Tax Officer that the assessee had submitted the said working and that the same could not be treated as an admission as being cost of the flats as was sought to be done by the Tribunal. Our attention was further drawn to the extract from the accounts to show that the amount of

Rs.60,000/was treated as sale price of the said flats in view of the fact that the relevant payment had been received from different purchasers between 29/12/1970 to 28/1/1971 and that all the dates fell within the accounting year under consideration. Mr.Karia further submitted that as per hire purchase agreement, which was entered into by the assessee with the intending purchasers, over and above the down payment made by the purchasers they were required to pay a lease rent of Rs.150/- p.m. for a period of 20 years. That the assessee had shown the lease rent accordingly for each of the subsequent assessment years commencing from assessment year 1972-73 and the same has been brought to tax accordingly and thus if the assessee was saddled with the addition of so called closing stock there would be two fold addition in relation to same transaction which was not warranted in law. Mr.B.B.Nayak, learned Counsel appearing on behalf of the revenue submitted that what would be the cost or a market price of a particular property would be a finding of fact and similarly whether a sale had taken place or not would also be a finding of fact and this Court should not interfere with the findings recorded by the Tribunal.

10. Having heard both the sides we inquired of the learned Counsel as to whether the addition of Rs.32,000/made for year under consideration as value of closing stock was taken as opening stock for the immediately succeeding year viz. assessment year 1972-73. Because the assessment order for A.Y. 1972-73 and other papers did not form part of the record we called for those papers and with the consent of both the sides the same have been taken on record.

11. The principles regarding valuation of closing stock have been very succinctly stated by the Apex Court in the case of Chainrup Sampatram vs. C.I.T.(1953) 24 I.T.R. 481. We may reproduce the relevant extract from the said decision wherein the Court was called upon to decide the controversy in the context of whether the sum in question fell within the taxable territory or not and hence the observations relating to situs of arising or accrual of profits have been omitted by us.

" xxx xxx It is wrong to assume that the valuation of the closing stock at market rate has, for its object, the bringing into charge any appreciation in the value of such stock. The true purpose of crediting the value of unsold

stock is to balance the cost of those goods entered on the other side of the account at the time of their purchase, so that the cancelling out of the entries relating to the same stock from both sides of the account would leave only the transactions on which there have been actual sales in the course of the year showing the profit or loss actually realised on the year's trading. As pointed out in paragraph 8 of the Report of the Committee on Financial Risks attaching to the holding of Trading Stocks, 1919, 'As the entry for stock which appears in a trading account is merely intended to cancel the charge for the goods purchased which have not been sold, it should necessarily represent the cost of the goods. If it is more or less than the cost, then the effect is to state the profit on the goods which actually have been sold at the incorrect figure .... From this rigid doctrine one exception is very generally recognised on prudential grounds and is now fully sanctioned by custom, viz., the adoption of market value at the date of making up accounts, if that value is less than cost. It is of course an anticipation of the loss that may be made on those goods in the following year, and may even have the effect, if prices rise again, of attributing to the following year's results a greater amount of profit than the difference between the actual sale price and the actual cost price of the goods in question' (extracted in paragraph 281 of the Report of the Committee on the Taxation of Trading Profits presented to British Parliament in April 1951). While anticipated loss is thus taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into the account, as no prudent trader would care to show increased profit before its actual realisation. This is the theory underlying the rule that the closing stock is to be valued at cost or market price whichever is the lower, and it is now generally accepted as an established rule of commercial practice and accountancy. As profits for income-tax purposes are to be computed in conformity with the ordinary principles of commercial accounting, unless of course, such principles have been superseded or modified by legislative enactments, unrealised profits in the shape of appreciated value of goods remaining unsold at the end of an accounting year and carried over to the following

year's account in a business that is continuing are not brought into the charge as a matter of practice, though, as already stated, loss due to a fall in price below cost is allowed even if such loss has not been actually realised .....

Again, it is misconception to think that any profit 'arises out of the valuation of the closing stock' .....As already stated, valuation of unsold stock at the close of an accounting period is a necessary part of the process of determining the trading results of that period, and can in no sense be regarded as the 'source' of such profits ..... The source of the profits and gains of a business is indubitably the business ..... As such profits can be correctly ascertained according to the method adopted by an assessee only after bringing into the trading account his closing stock wherever it may exist ..... "

This principle has very recently been reiterated by the Apex Court in the case of Sakthi Trading Co. vs. C.I.T.2001 AIR SCW 2859 :

"14. This Court thus held that the proper practice is to value the closing stock at cost. That will eliminate entries relating to the Same stock from both sides of the account. To this rule, custom recognises only one exception and that is to value the stock at market value if that is lower. But on no principle can one justify the valuation of the closing stock at a market value higher than cost as that will result in the taxation of notional profits the assessee has not realised ... "

12. Applying the aforesaid test to the facts of the case at hand it is apparent that the method for the purpose of valuation of closing stock that is adopted by the assessee is : cost or market price, whichever is lower. Accordingly, the assessee having treated transaction of hire purchase as part sale, declared the

amount received during the accounting period as profits relatable to the sale transaction during the year under consideration. According to the assessee the payment received by it as part of the hire purchase transaction was market price of the property in relation to such transaction and that is how the assessee treated the same and entered accordingly in the trading account.

13. As mentioned hereinbefore on a point of fact it was found necessary to ascertain whether the addition of Rs.32,000/- made as closing stock during the year under consideration was given credit as opening stock of the next year. We had called for the papers relatable to assessment year 1972-73. This became necessary in view of the fact that it was revenue's stand that the sale had taken place in subsequent accounting period i.e. previous year relatable to assessment year 1972-73. As per assessment order dated 31/3/1980 for assessment year 1972-73 the Income Tax Officer recast the trading account and took Rs.92,000/- as opening stock for the said year

and worked out the profits accordingly. It is pertinent to note that he has taken sales at Rs.1,48,000/- as having occurred during the previous year relevant to assessment year 1972-73. The assessee challenged the said treatment of addition and the order of learned C.I.T.(Appeals) is available at pages 80 to 84 of the Paper Book. In his order dated 25/4/1981, the learned C.I.T.(Appeals) has specifically come to a conclusion after appreciating the evidence on record that there is no sale even during the assessment year 1972-73 and "hence the question of taxing profit on sale of flats does not arise". In the order dated 4/5/1981 giving effect to the order of C.I.T.(Appeals), we find that the assessee has been assessed on the total income as was originally assessed, deleting the addition made for assessment year 1972-73. We were informed at the bar that the appellate order dated 25/4/1981 for assessment year 1972-73 has been accepted by the revenue and no further proceedings for the said year are pending.

14. The resultant effect of the aforesaid position is that the revenue has accepted the stand that there are no sales taxable during the accounting period relevant to assessment year 1972-73. This was the basis viz.,that sales had taken place in the subsequent accounting period and hence the assessee was required to show the closing stock for the year under consideration, for reopening assessment of the year under consideration and making

addition of Rs.32,000/-. Once it is found on facts that

that no sales have taken place in subsequent year the entire basis on which the action of the I.T.O. is found disappears. In view of this position there would be no reason to uphold the view of the Tribunal. Moreover, there is nothing on record to show that the sum of Rs.60,000/- shown by the assessee in its trading account was not the market price as was held by the Tribunal, because in fact as can be seen from the accounts the said sum had actually been received from the purchasers. Further, it cannot be disputed that it was for the assessee to adopt the valuation of closing stock at cost or market price whichever is lower, that being the settled legal position. The assessee having adopted the market price for the purpose of valuation, it would not be possible to uphold the order of the Tribunal.

15. Mr.B.D.Karia, learned Counsel, appearing on behalf of the applicant-assessee did not press question No.1 referred at the instance of the assessee and hence we decline to answer the same. Therefore, on the assumption that the reopening proceedings had been validly initiated, we hold the Tribunal was not justified in valuing the closing stock at Rs.92,000/- resulting in addition of Rs.32,000/- especially when the closing stock had been properly valued on the basis of the market price which was lower of the two i.e.market price or cost. Hence, we answer question No.5 in the Negative i.e. in favour of the assessee and against the revenue.

16. In view of our finding as regards question No.5, it is not necessary for us to answer question Nos. 2,3,4 and 6 and we decline to answer the same.

17. The reference stands disposed of accordingly with no order as to costs.

Sd/- Sd/-
(M.S.Shah, J) (D.A.Mehta, J)
m.m.bhatt